

STATE BANKING: A STUDY IN DUAL REGULATION

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State-chartered banks have been on the American scene since the earliest days of the Republic. A number of them, even today, operate under special charters granted by their state legislatures in the days before general incorporation statutes. By 1868, however, only five years after the creation of a system of federally chartered national banks, state banking seemed to be on the way out. Conversions to national charter had been widespread, largely because of a prohibitive federal tax on bank-notes issued by state-chartered banks, and the number of commercial banks under state supervision throughout the country dwindled to 247. From that low point, the number of state-chartered banks increased steadily as commercial banks made more and more use of demand deposits as money and less and less use of bank-notes. Today, state-chartered banks account for roughly two-thirds of the nation's 14,000 commercial banks. In addition, *all* of the nation's mutual savings banks, *all* of the nation's stock savings and loan associations, and sixty-three per cent of the nation's mutual savings and loan associations are state-chartered.¹

These figures, however, overstate the actual strength of the principal financial institutions under state supervision. More than \$220 billion of the nation's commercial bank assets are held by federally chartered national banks, while less than \$160 billion of such assets are held by state-chartered commercial banks. Put another way, the average national bank has \$45.7 million in assets and the average state-chartered commercial bank only \$17.6 million in assets. Similarly, the far less numerous federal savings and loan associations hold \$67 billion of the nation's savings and loan assets as contrasted with the \$63 billion in assets held by all state-chartered associations. As a result, the average asset size of federal savings and loan associations—\$33 million—is more than twice the \$15 million average asset size of state-chartered associations. It is only because state banking systems include \$58 billion in assets held by the nation's mutual savings banks, all of which are state-chartered, that they can boast forty-nine per cent of the total assets held by all the country's commercial banks, savings banks, and savings and loan associations.

Two other statistical observations might be made which place the nation's state banking systems in proper perspective. The first is that among the larger financial institutions which have a choice between federal or state supervision, a substantial majority have chosen federal supervision. Thus, of the nation's 397 commercial banks with deposits of more than \$100 million, sixty-three per cent are national banks under

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¹ All figures in this article, unless otherwise stated, are as of December 31, 1965.

federal supervision. Of the nation's 130 mutual savings and loan associations with savings of more than \$100 million, eighty-one per cent are under federal supervision.

Second, the most significant state banking systems are found in just twelve states, each of which has more than \$5 billion in commercial-bank, savings-bank, and savings-and-loan-association assets subject to state supervision. These states are California, Connecticut, Illinois, Massachusetts, Michigan, Missouri, New Jersey, New York, Ohio, Pennsylvania, Texas, and Wisconsin.² In the aggregate, the state banking systems in these twelve states account for more than \$210 billion of the \$280 billion in assets subject to state supervision throughout the country, with the New York State banking system alone accounting for almost \$80 billion of that total.

I

THE THEORY OF STATE REGULATION

In banking, as in many other areas of business regulation, there can be decided advantages to a system of state regulation as distinct from a system of federal regulation. It should be possible to shape the governing law, and the regulations which implement it, more precisely to the local or regional needs of a particular state than under a national system of regulation. It should be possible to achieve legislative change more quickly from a state legislature in the face of changing circumstances than from a national Congress, whose attentions must necessarily be given to a broader range of problems, both foreign and domestic. It should also be possible, as a practical matter, to gain a hearing before the responsible state officials and state legislators more conveniently and more quickly than before their federal counterparts, who usually have broader concerns and larger constituencies. Moreover, under a system of state regulation, there can be a greater willingness to innovate and experiment because experience can be gained in limited areas and under controlled conditions.

The attractiveness of purely federal regulation increases in direct proportion to the failure of a state banking system to realize these advantages in practice. Perhaps most destructive of all is a state banking system characterized by indifference or inertia in the face of changes in the banking requirements of American business or the general public. This indifference or inertia may be the result of lethargic leadership or inadequate staff in a state banking department, political stalemate at the state legislative level, the inability of supervisory personnel to recognize changing conditions or to review matters with an open mind, or a lack of coordination between state and federal supervisory agencies or between different federal agencies.

² Five of these states (Connecticut, Massachusetts, New Jersey, New York, and Pennsylvania) have \$1 billion or more in assets attributable to mutual savings banks. The State of New York alone had \$33.6 billion in mutual savings bank assets subject to state supervision at December 31, 1965.

II

STATE REGULATION IN PRACTICE: FEDERAL-STATE PROBLEMS

If state banking systems were regulated exclusively by state law and state banking departments, the fifty states could properly be charged with full responsibility for the regulatory framework within which state banks and other state-chartered institutions must compete with each other and with their federally chartered counterparts. In many matters of competitive importance, however, state-chartered banks and other institutions are restricted by federal law or by the rulings of a federal bank agency having jurisdiction over them. In addition, almost all of them, being federally insured, are subject to regular examination by a federal bank agency as well as by their state banking department.³

This interrelationship of state and federal authority is little recognized by the general public, but to state supervisors and state banks alike it presents some of the most difficult problems in the present system of regulating state-chartered institutions—problems which are common to state banking systems throughout the country. The three areas discussed below comprise the most significant of the problems arising at the federal level.

A. Dual Examinations

Almost all state-chartered financial institutions, as previously noted, are subject to periodic examination by a federal bank agency in addition to periodic examinations by their state banking department. By contrast, national banks are regularly examined only by the Comptroller of the Currency, and federal savings and loan associations are regularly examined only by the Federal Home Loan Bank Board.

Dual examinations of the same institution by federal and state authorities can be duplicative and expensive. Unless the examinations are conducted at the same time and carefully coordinated, normal bank operations can be seriously disrupted. Even when a joint examination is made—the usual practice in New York—perfect coordination between the two agencies is difficult to attain in practice. Frequently, they seek information which is slightly different or in different form. Each agency has a separate responsibility to evaluate the institution's lending practices, and where credit files do not lend themselves to a single abstract for both agencies (they generally do not in small banks and small associations), each agency must make its own review of the credit files. Two examination reports are prepared, and these are frequently submitted to the institution's board of directors or trustees at different times even though both agencies may have made their examinations as of the same date.

In a recent report, an eminent New York Advisory Committee on Commercial

³ State banks which are members of the Federal Reserve System are examined regularly by Federal Reserve examiners. Federally insured state banks which are not members of the Federal Reserve System are examined regularly by the Federal Deposit Insurance Corporation. Federally insured state-chartered savings and loan associations are examined regularly by the Federal Savings and Loan Insurance Corporation, which is managed by the Federal Home Loan Bank Board.

Bank Supervision made the following observations on the subject of dual examinations:

The burden of dual examinations is greatest on the small banks. One reason for this is that the size of the examining force is large relative to the size of the bank and to the number of its employees. There is less space available which can conveniently be given to the examiners for their desk work, and their presence in the initial phase of cash, securities and records control is less easily absorbed. Any temporary overstaffing is strongly felt.

It is in the small bank where mechanization of activities is least likely to be found. Thus, the preparation of different lists and schedules for each agency, which may be relatively simple with advanced office equipment, may be a significant burden. Overtime work often is the result.

Lastly, it is sometimes claimed by bankers in the smaller communities that the presence of examiners has a disturbing effect on customers and the general public. Where such is the case, multiple examinations and temporary overstaffing of examiners tend to compound this problem.⁴

Moreover, under the assessment formula required by law to be used in New York, the annual cost to a smaller state-chartered commercial bank for its share of the expenses of the State Banking Department is usually greater than the annual cost to a national bank of the same size for its share of the expenses of the Comptroller's office.⁵ Furthermore, at least in assessment states, any disparity of examination expense between federally chartered, and state-chartered institutions becomes more pronounced as a state banking department, through better paid staffs and a full complement of examiners, becomes better able to fulfill its supervisory responsibilities.

The New York Advisory Committee considered several alternatives aimed at reducing the burden of dual examinations, including a system of separate examinations alternating year by year between the federal agency having jurisdiction and the state banking department. It found this suggestion, and variations of it, to be impractical because of the staffing and scheduling problems which they produce. However, it did recommend that the federal agencies involved cease to conduct regular examinations of their own and rely instead upon the reports of examination prepared by the staffs of state banking departments they consider qualified to carry out this responsibility. It noted that no change in federal law would be necessary

⁴ ADVISORY COMMITTEE ON COMMERCIAL BANK SUPERVISION, SECOND REPORT SUBMITTED TO THE SUPERINTENDENT OF BANKS OF THE STATE OF NEW YORK 18-19 (September 1966) [hereinafter cited as NEW YORK ADVISORY COMMITTEE, SECOND REPORT].

⁵ Each state-chartered bank in New York is individually charged for the direct costs of examining such institution, and the Department's remaining overhead expenses (with certain exceptions) are assessed against all banking organizations under its supervision according to a formula based on their asset size. National banks are not individually charged for the cost of examinations; instead, the total expenses of the Office of the Comptroller, including examination expenses, are assessed against them according to a formula based upon their asset size. As it generally takes proportionately more man-hours to examine smaller banks than larger banks, the total national bank assessment is less expensive for smaller banks, and more expensive for larger banks, than the total New York assessment.

to implement this proposal and that the federal agencies would continue to have authority to make examinations in special circumstances.⁶ The Committee's Report went on to say:

This approach obviously would require the federal agencies to determine which of the 50 state supervisory authorities, if any, they consider capable of conducting bank examinations alone. This decision may be a difficult one for these agencies to make.

However, this Committee believes that the long-term benefits to be derived from such a decision would far exceed the burden of making it. These benefits would accrue in the first instance to the banks which would be relieved of the hardships of multiple and duplicating examinations, which is the immediate purpose of the proposal. But beyond this, it would encourage in a positive way the states whose supervisory departments do not meet the standards established for this purpose to upgrade these departments.

There is now very little incentive for states to strengthen their supervisory departments, a process which requires enlarged budgets for more and better-paid supervisory personnel. Under present arrangements the states can rely upon the federal banking agencies to supervise at no direct cost all state-chartered insured banks. Furthermore, banks not subject to stringent state examination would be unlikely to support any movement to impose upon them the burdens of dual examinations where they do not now exist, particularly so if the banks were to be assessed for the expenses incurred.

However, we believe that the acceptance of state reports of examination by the federal banking agencies would stimulate the various states and their state-chartered banks to strive for strong, effective state banking departments. This, in turn, would strengthen the dual banking system as much as any other method could. Strong state banking departments are a necessary ingredient in a strong dual system; without them the state bank portion of the dual system can only fall into disrespect and finally into disuse.⁷

To reduce the added expense to state-chartered banks of supporting a high-quality state banking department in states which assess the department's expenses, the Committee recommended that the federal agencies "assume an equitable portion of the cost of the examinations made on their behalf."⁸

A resolution of the "dual examination" problem in line with the New York Advisory Committee's recommendations would constitute a major step forward in state banking regulation because it would provide an incentive for strong state banking

⁶ NEW YORK ADVISORY COMMITTEE, SECOND REPORT 20-21. The Federal Home Loan Bank Board has similar authority to accept state banking department reports of the examination of state-chartered savings and loan associations which are federally insured; see National Housing Act § 403(b), 12 U.S.C.A. § 1726(b) (Supp. 1966).

⁷ NEW YORK ADVISORY COMMITTEE, SECOND REPORT 21-22. It was recognized that special examination arrangements would have to be made in order to assure the Board of Governors of the Federal Reserve System that their various regulations were being obeyed by state member banks, but the Committee felt this could be accomplished by special training of state bank examiners or by limited examinations by the Federal Reserve System itself. *Id.* at 23.

⁸ *Id.* at 24. Congressional authorization may be necessary to implement this part of the Committee's recommendation.

departments and at the same time remove the most tangible burdens of being subject to the jurisdiction of two supervisory agencies. As the Committee suggests, the implementation of its recommendations would benefit most the smaller state-chartered institutions (which have in New York and other states significant reasons for preferring a state charter but for the burden of dual examinations⁹), although even the largest state-chartered institutions would welcome the elimination of duplication and administrative waste inherent in the present system of dual examinations.

B. Federal Reserve Obstacles

As a financial institution becomes larger, extending the range and scope of its activities, it comes quite naturally into increasingly frequent contact with its supervisory authority. Commercial banks in this group are the most active, as a rule, in branching or merging, in seeking lendable funds, and in utilizing different forms of commercial lending. If they are state-chartered, the closest coordination between federal and state supervision becomes necessary to prevent the requirements of dual regulation from becoming so annoying and abrasive as to outweigh any advantages of a state charter. For these larger banks, the "dual examination" problem is less significant as a competitive matter than other problems involved in the present system of dual supervision. Since almost all state banks of large size are members of the Federal Reserve System, the consequences of supervision at the federal level include, among other things, the matters discussed under this topic below. In the absence of remedial action taken at the federal level, a large state-chartered bank could escape the competitive disadvantages noted below only by converting to national bank status or by becoming a nonmember state bank. Since few, if any, of these larger banks would seriously consider withdrawing from the Federal Reserve System, the one practical alternative left under present conditions, once a bank concludes that these disparities are of overriding importance to its competitive position, is conversion to national bank status.¹⁰

I. Operations Subsidiaries

Even where state law is favorable, as it is in New York,¹¹ a state bank which is a member of the Federal Reserve System may not organize or acquire a subsidiary

⁹ See text accompanying notes 39-42 *infra*.

¹⁰ National banks by law must be members of the Federal Reserve System, but primary supervision of these member banks is vested in the Comptroller of the Currency. Conversion, therefore, will not require the large state member banks to surrender any of the benefits of Federal Reserve membership, but it will permit the large state member bank to rid itself of some significant adverse consequences which result from being subject, as a state member bank, to the jurisdiction of the Board of Governors of the Federal Reserve System.

¹¹ A New York-chartered commercial bank has broad authority to invest in the capital stock of any corporation provided it first obtains the approval of the New York State Banking Board. N.Y. BANKING LAW § 97(5). Thus, if only New York law had to be considered, a state-chartered bank could organize or purchase a subsidiary of any kind, including another banking organization or an unrelated business corporation, so long as the State Banking Board approved. In fact, the possibilities for state-chartered banks under New York law are far broader than they are even for national banks under the most recent rulings of the Comptroller of the Currency.

corporation to carry on any part of the business of banking unless federal law specifically permits the type of subsidiary contemplated. National banks are under no such disability so long as the subsidiary is intended to perform a part of the business of banking or functions incidental thereto. The difference in result is not due to the provisions of federal law, which actually contemplate the same powers for both groups of banks, but to the differing interpretations of those provisions by the Board of Governors of the Federal Reserve System and the Comptroller of the Currency.

State-chartered banks which are members of the Federal Reserve System are bound by the provisions of the Federal Reserve Act and, as a practical matter, by the interpretations of that act issued by the Board of Governors of the Federal Reserve System. Under the Federal Reserve Act, the stock investments which state-member banks may make are limited to those which national banks may make.¹² The Board of Governors, however, takes a far more restrictive view than does the Comptroller of the Currency of the provisions of the National Bank Act which bear on the authority of national banks, and thus of state-member banks, to invest in subsidiary corporations. The Board has ruled that stock of "operations subsidiaries," exclusive of the types specifically permitted elsewhere in federal law, cannot be purchased by member banks because no express provision of federal law permits them and because the power to purchase their stock cannot properly be regarded as an incidental power necessary to carry on the business of banking.¹³ The Comptroller of the Currency has reached a contrary conclusion.¹⁴

Although national banks are also members of the Federal Reserve System, the Board of Governors has not moved to apply its interpretation to them. The end result has been that national banks have gone unchallenged in their acquisitions of "operations subsidiaries," while New York-chartered banks are barred from such acquisitions, not by state law but by an interpretation of a federal law which Congress obviously intended should apply in the same way to all members of the Federal Reserve System, whether state-chartered or federally chartered. As a result, large state-chartered banks cannot realize any of the possible advantages of having subsidiaries while national banks can. These possible advantages include a greater degree of flexibility in the organizational structure of the bank; the ability to acquire a working interest in bank-related businesses; the ability to retain the good will of an acquired company by continuing to operate it as a separate entity; tax benefits, particularly with respect to interstate transactions; and even in some cases a limitation on the bank's tort liabilities.

¹² Federal Reserve Act § 9, 12 U.S.C. § 335 (1964).

¹³ 31 Fed. Reg. 10021, 10356 (Board of Governors of the Federal Reserve System, 1966), adding § 208.119 to title 12 of the Code of Federal Regulations.

¹⁴ 31 Fed. Reg. 11459 (Comptroller of the Currency, 1966), adding § 7.10 to title 12 of the Code of Federal Regulations. See Robertson, *Federal Regulation of Banking: A Plea for Unification*, in this symposium, pp. 673, 683-86.

A failure to resolve this dispute promptly, by act of Congress or by an administrative interpretation uniformly applicable to both national and state member banks, is likely to have profound and serious consequences for all state banking systems.

2. *Underwriting of Revenue Bonds*

Under the terms of the Federal Reserve Act, state member banks are subject to the same limitations and conditions with respect to underwriting, dealing in, and holding investment securities as national banks.¹⁵ While the National Bank Act provides that a national bank has no general authority to underwrite or deal in such securities, there is an exception for "general obligations of any State or of any political subdivision thereof."¹⁶ The Board of Governors of the Federal Reserve System interprets this exception to deny state member banks the right to underwrite or deal in "revenue bonds" of states and political subdivisions, whereas the Comptroller of the Currency interprets the same exception to permit national banks such power subject only to the exercise of prudent banking judgment.¹⁷

The issuance of revenue bonds by the fifty states and their political subdivisions, *i.e.*, bonds payable from a specified fund of revenues or a specified tax rather than general tax revenues, has increased significantly in relative volume since the enactment of the Banking Act of 1933, which added the above provisions to the Federal Reserve Act and the National Bank Act. At that time, revenue bonds were so insignificant a factor in municipal financing that no separate statistics were kept as to their issuance. Today, they account for approximately one-third of the dollar value of all state and municipal obligations issued. The popularity of revenue bonds is likely to increase even more in the future as states and municipalities seek to finance major capital expenditures outside the framework of constitutional and statutory provisions enacted many years ago to limit the issuance of "full faith and credit" bonds. Wholly aside from the merits of the question of whether or not banks should be allowed to underwrite and deal in revenue bonds to the same extent that they can underwrite and deal in "full faith and credit" bonds, the existing impasse between the Board of Governors of the Federal Reserve System and the Comptroller of the Currency as to the meaning of the "general obligation" exception in the National Bank Act means that state member banks do not have the same competitive opportunities as national banks to underwrite these obligations.¹⁸

¹⁵ Federal Reserve Act § 9, 12 U.S.C. § 335 (1964).

¹⁶ National Bank Act § 8, 12 U.S.C. § 24 (1964).

¹⁷ For the Federal Reserve position on this subject, see 12 C.F.R. § 208.105 (Supp. 1966), reaffirmed in 12 C.F.R. § 208.107, .113 (Supp. 1966). For the Comptroller's position, see 12 C.F.R. § 1.3 (Supp. 1966).

¹⁸ Recent efforts to resolve this dispute by congressional legislation have failed of enactment. In the meantime, a group of underwriting firms have successfully challenged the Comptroller's ruling in the U.S. District Court for the District of Columbia. *Baker, Watts & Co. v. Saxon*, 261 F. Supp. 247 (D.D.C. 1966).

3. *Dual Approvals for Branches and Mergers*

Most state-chartered banks must obtain the approval of two supervisory agencies before they can open a *de novo* branch or merge with another bank. In addition to the approval of its state banking department, a state-chartered bank which is a member of the Federal Reserve System must also obtain the approval of the Board of Governors of the Federal Reserve System,¹⁹ and a state-chartered nonmember bank which is federally insured must obtain the approval of the Federal Deposit Insurance Corporation.²⁰ By contrast, a national bank need only obtain the approval of the Comptroller of the Currency for either type of action.²¹

The two approvals required for state-chartered banks cause complications in the application process and frequently result in long delays between the first filing of the application and final action, particularly in the case of merger applications.²² State and federal agencies have different application forms, conduct separate field investigations, and make separate office analyses. In the case of the federal agencies, regional offices submit recommendations to their respective head offices in Washington, and final decisions are made by the governing boards of the Federal Reserve System or the FDIC.

After examining this problem, the New York Advisory Committee on Commercial Bank Supervision recommended that the two agencies delegate authority for final decisions on branch applications of state-chartered banks to their regional offices, within policy standards prescribed by their governing boards.²³ A similar delegation was not recommended for merger applications in view of their difficulty and sensitivity, but the two agencies involved were urged to act more expeditiously. The development of a joint federal-state application form for mergers and other acquisitions were also encouraged.²⁴

¹⁹ For requirements for branch applications, see, e.g., N.Y. BANKING LAW § 29; Federal Reserve Act § 9, 12 U.S.C. § 321 (1964). For requirements for merger applications, see, e.g., N.Y. BANKING LAW § 601-b; 12 U.S.C.A. § 1828(c) (Supp. 1966).

²⁰ For requirements for branch applications, see, e.g., N.Y. BANKING LAW § 29; Federal Deposit Insurance Act §§ 6, 18(d), 12 U.S.C. §§ 1816, 1828(d) (1964). For requirements for merger applications, see, e.g., N.Y. BANKING LAW § 601-b; 12 U.S.C.A. § 1828(c) (Supp. 1966).

²¹ For requirements for branch applications, see 12 U.S.C. § 36 (1964). For requirements for merger applications, see 12 U.S.C.A. § 1828(c) (Supp. 1966), and National Bank Act § 20, 12 U.S.C. § 215a (1964).

²² Under the New York Banking Law, a decision by the State Banking Department on a merger-type application of a state-chartered bank must be reached within 120 days of the date of filing. N.Y. BANKING LAW § 601-b(1). The federal agencies with jurisdiction over such applications are subject to no such statutory time limit, and substantial delays have occurred at the federal level.

²³ In 1966 Congress enacted a statute which authorizes the Board of Governors of the Federal Reserve System to delegate responsibility for deciding certain applications to its district Federal Reserve Banks. 12 U.S.C.A. § 248 (Supp. 1966). The Federal Deposit Insurance Corporation is already authorized under existing law to delegate responsibility for deciding branch applications to its district offices. Federal Deposit Insurance Act § 9, 12 U.S.C. § 1819 (1964).

²⁴ NEW YORK ADVISORY COMMITTEE, SECOND REPORT 35. The Committee further recommended that, until such a joint application form is developed, the Banking Department accept a copy of the applications filed with the federal banking authorities and, if the Department believes additional information is needed, require such additional information to be submitted in the form of a supplemental statement. *Id.* at 36.

C. The "Federal Instrumentality" Theory and a Bank's Ability to Compete Across State Lines

When a business corporation "does business" outside its home state without qualifying under local law, it runs the risk that it may be unable to enforce its contracts in the local courts. This potential disability can usually be overcome by meeting the statutory qualification requirements in each state, which generally include a continuing liability for state and local taxes and the designation of some public official for local service of process.

National banks are generally treated as though they are exempt from such qualification requirements and the disabilities which attach to noncompliance. The national bank exemption, even when expressly provided by state law, can be traced back to two early decisions of the United States Supreme Court which struck down state efforts to impose special taxes upon the federally chartered Bank of the United States, *McCulloch v. Maryland*²⁵ and *Osborn v. Bank of the United States*.²⁶ There are significant differences between the national banks of today and the Bank of the United States,²⁷ as well as conflicting lines of Supreme Court authority,²⁸ which could be used to uphold state power to regulate and tax out-of-state national banks in a nondiscriminatory manner. Yet national banks continue to be considered "instrumentalities" of the federal government and, as such, entitled constitutionally to exemptions from state regulation and taxation except to the extent the exemptions are specifically set aside by Congress.²⁹ Since Congress has not specifically permitted nondomiciliary states to tax or regulate national banks at all, the result is a broad exemption for the interstate transactions of national banks.

State-chartered banks have been accorded no such broad exemption when they do

²⁵ 17 U.S. (4 Wheat.) 316 (1819).

²⁶ 22 U.S. (9 Wheat.) 738 (1824).

²⁷ National banks, while chartered under federal law, are business corporations, privately owned, privately managed and operated for the benefit of private stockholders. The functions national banks perform for the federal government, such as accepting deposits of government funds, are no different from the functions performed for the federal government by state-chartered banks which are members of the Federal Reserve System. National banks no longer may issue circulating paper currency, a unique privilege they once possessed. The Bank of the United States, on the other hand, was a federally chartered central bank, performing vital governmental functions. The federal government subscribed to and owned 20% of the Bank's stock, and had the power to appoint a part of its board of directors. The Secretary of the Treasury was required to deposit all public money of the federal government in the Bank or, if he did not, was required to report his reasons for not doing so to Congress. The Bank acted as fiscal agent for the federal government, was required to transmit government funds without charge and handled the federal government's foreign exchange transactions. Circulating paper currency issued by the Bank was made legal tender for all debts to the federal government. After the Bank's charter expired in 1836, Congress never again chartered any similar central bank. See 12 U.S.C. § 265 (1964); PAUL STUDENSKI & H. E. KROOS, *FINANCIAL HISTORY OF THE UNITED STATES* 83-88, 103-106, 393 (1952).

²⁸ Compare *Colorado Nat'l Bank v. Bedford*, 310 U.S. 41 (1940), with *Owensboro Nat'l Bank v. Owensboro*, 173 U.S. 664 (1899), and *United States v. Muskegon*, 355 U.S. 484 (1957); *United States v. Detroit*, 355 U.S. 466 (1957); *Anderson Nat'l Bank v. Lockett*, 321 U.S. 233 (1944); *Graves v. New York*, 306 U.S. 466 (1939); *McClellan v. Chipman*, 164 U.S. 347 (1896); *Union Pac. R.R. v. Penniston*, 85 U.S. (18 Wall.) 5 (1873).

²⁹ See, e.g., *Bank of America v. Lima*, 103 F. Supp. 916 (D.C. Mass. 1952).

business across state lines. Generally speaking, they must meet the "doing business" and "blue sky" requirements which states impose on out-of-state business corporations and their securities. What is more, in some states, for certain types of transactions, a bank chartered by another state cannot legally qualify even if it were willing to do so and to pay the taxes normally imposed on out-of-state business corporations.³⁰ Furthermore, the designation of some public official to accept local service of process subjects a state-chartered bank to suit outside its home state, whereas national banks, by specific act of Congress, may be sued only in the state in which they have their principal banking office.³¹

Prior to the recent ruling of the Board of Governors of the Federal Reserve System that state member banks may not establish or purchase the stock of "operations subsidiaries," except in limited circumstances,³² it was thought possible that state-chartered banks might be able to overcome many of the disadvantages which they face in doing business across state lines by forming subsidiary corporations to carry on the interstate portions of their domestic banking business. The issuance of that ruling appears, as a practical matter, to leave only one avenue open for the resolution of this competitive disparity with national banks, and that is an act of Congress which would equalize the position of state and national banks in doing business across state lines.³³

As the volume of interstate bank business grows, the privileged position of national banks in this area is bound to place even greater pressure on the state-chartered segment of the dual banking system in the future than it has in the past.³⁴ For in the present state of the law, a state-chartered bank faced with regulatory or tax consequences in a particular state which it considers unacceptable must generally decline to do business in that state. By the same token, a commercial bank which desires for competitive reasons to provide a particular banking service to customers in all fifty states is almost required to have a federal charter so that it may avail itself of the exemptions which are accorded, rightly or wrongly, to national banks.

III

DEFICIENCIES IN STATE ADMINISTRATION AND STATE LAW

In addition to the problems introduced at the federal level in the supervision of

³⁰ For example, some states permit only banks chartered under their own laws, or national banks, to use the word "bank" in a corporate title, thus foreclosing in such states the sale of travellers' checks issued by a state bank chartered in another state even though that state bank might be willing to comply with local "doing business" statutes if it legally could. The result is that an out-of-state national bank may sell travellers' checks in these states, but a similarly situated state-chartered bank may not.

³¹ National Bank Act § 30, 12 U.S.C. § 94 (1964).

³² See discussion *supra* pp. 738-40.

³³ A bill to give insured state-chartered banks doing business across state lines the same privileges, protections, and immunities possessed by national banks in conducting such business, was recently introduced in Congress upon my recommendation. H.R. 539, 90th Cong., 1st Sess. (1967).

³⁴ State-chartered savings and loan associations doing an interstate business also face many of the same restrictions that state banks face, *Chattanooga Nat'l Bldg. & Loan Ass'n v. Denson*, 189 U.S. 408 (1903), while federal savings and loan associations, like national banks, enjoy almost complete immunity from such restrictions. *People v. Coast Fed. Sav. & Loan Ass'n*, 98 F. Supp. 311 (S.D. Cal. 1951).

state-chartered financial institutions, there are others introduced at the state level which individual states can remedy by themselves if they are concerned enough to do so.

A. State Regulatory Agencies

Each of the fifty states has a state banking department which supervises the safety and soundness of state-chartered commercial banks.³⁵ In the eighteen states which permit mutual savings banks, these institutions are also supervised by the same agency which supervises state-chartered commercial banks.³⁶ State-chartered savings and loan associations are separately supervised in eighteen states, but in the remaining thirty-two states they come under the jurisdiction of the state banking department. State banking departments may also supervise a variety of other financial organizations, including state-chartered credit unions, small-loan companies, sales finance companies, check cashers, transmitters of money, and pawnbrokers. In Minnesota, New Jersey, and Vermont, the same state agency supervises both insurance companies and state-chartered banking organizations, and in seven states the state banking department also administers the state's securities laws.

The breadth of supervisory responsibility placed in a particular state banking department may have an important bearing on the adequacy and effectiveness of its staff. State banking departments in twenty-four states, including seven of the twelve states with the largest state banking systems, depend in whole or in part upon industry assessments to support their operations. In states where industry assessments reimburse a major part of the expenses of the department, its effectiveness will be closely related to the aggregate assets subject to supervision, irrespective of the types of organizations the department supervises. In other states, the department's effectiveness will depend on the degree of legislative support it is able to command over an extended period of time.

Most state banking departments are required by law to examine the institutions subject to their jurisdiction once a year, with two examinations a year required in thirteen states. To carry out this function, and others assigned to the department, the fifty states employ approximately 1,500 bank examiners, sixty per cent of whom are employed by the twelve states having the largest state banking systems. Twenty-three states do not provide civil service protection for their bank examiners, and most examiners receive less than \$10,000 per year.³⁷ The salary of the highest paid professional examiner is invariably less than the salary of the head of the department, and in mid-1964 only seven heads of department received a salary of \$18,000 per year or

³⁵ All information in this section is taken from NATIONAL ASSOCIATION OF SUPERVISORS OF STATE BANKS, A PROFILE OF STATE-CHARTERED BANKING (August 1965), a survey based on 1964 data.

³⁶ In six of these states (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Washington), the assets of state-chartered mutual savings banks exceed the assets of state-chartered commercial banks.

³⁷ For some other pertinent data, see table in Redford, *Dual Banking: A Case Study in Federalism*, in this symposium, pp. 749, 762.

more. At that time, twenty-eight heads of department expressed the view that their department's budget was inadequate, and eighteen expressed the view that their examining staffs were inadequate in number to meet the department's statutory examination requirements. Very few departments employ full-time lawyers, despite the demands of state regulation and the proliferation of federal regulation over state-chartered institutions.³⁸

B. State Banking Laws

Many state laws which set forth the basic powers of state-chartered institutions are detailed and restrictive and lack the basic flexibility necessary to meet new banking conditions—a not unnatural consequence of the Depression days in which most such laws were drafted. Recent revisions at the state level, initiated by distinguished groups of bankers and lawyers in such states as New York, Pennsylvania, Ohio, and Oklahoma, have attempted to introduce this flexibility, and in some cases the end product has been a completely new banking code, shorn of the detailed and protective provisions which federal deposit insurance and other developments since 1929 have made unnecessary.

Each state, of course, has a different framework within which to achieve banking law reform. The law presently differs from state to state, and so does the competitive importance of the varying disparities of power which exist between state-chartered institutions and their federally chartered counterparts. The juxtaposition of political forces in the state legislative process will also differ markedly from one state to the next.

In New York, for example, small banks under state supervision actually have greater flexibility in some basic areas of bank operations than national banks. Their real estate lending authority is significantly broader,³⁹ their lending limit for secured loans to a single borrower is greater,⁴⁰ and in matters of corporate organization and action, state-chartered banks are less restricted.⁴¹ In addition, by choosing not to become members of the Federal Reserve System, the smaller New York-chartered

³⁸ Most state banking departments depend on the staff of the state's attorney general.

³⁹ The New York Banking Law, unlike the law applicable to national banks, does not require all mortgage loans to be first liens, does not require amortization of loans, does not generally set maximum maturities, and permits loans on unimproved real property. Compare N.Y. BANKING LAW § 103(4), with Federal Reserve Act § 24, 12 U.S.C.A. § 371 (Supp. 1966).

⁴⁰ New York law sets a limitation on secured loans to a single borrower of 25% of the bank's capital, surplus fund, and undivided profits. National banks, on the other hand, have (with certain exceptions) only a 10% lending limit for secured as well as unsecured loans. Furthermore, the New York Banking Law, unlike the National Bank Act, permits loans to a parent corporation to be treated separately from loans to its subsidiaries. Compare N.Y. BANKING LAW § 103(1), with National Bank Act § 29, 12 U.S.C. § 84 (1964).

⁴¹ New York law provides greater flexibility in the composition of a bank's board of directors, and, unlike federal law, does not require cumulative voting or the approval of shareholders for mergers, consolidations, or acquisitions of assets where the bank to be acquired is less than 10% of the size of the receiving bank. See N.Y. BANKING LAW §§ 601, 601A, 601B, 7001-7005; and compare National Bank Act §§ 9-11, 12 U.S.C. §§ 61, 71, 72-76 (1964); 12 U.S.C. §§ 215-215b (1964).

banks can meet their reserve requirements more cheaply than national banks, all of which must by law be Federal Reserve members.⁴²

Prior to the 1966 Session of the New York Legislature, however, the New York Banking Law had serious deficiencies insofar as larger state-chartered banks were concerned. After a thorough review of the many differences of detail in the powers of national banks and state-chartered commercial banks, the New York Advisory Committee on Commercial Bank Supervision submitted eleven recommendations to the Superintendent of Banks for changes in New York law, including recommendations to grant state-chartered banks direct leasing powers and the authority necessary to conduct a general factoring business.⁴³ Far more extensive revisions will be needed in other states which, unlike New York, have not had periodic amendments to keep their banking codes reasonably up to date.

IV

INTERRELATION OF STATE AND FEDERAL REFORMS

Deficiencies in state law and administrative organization have had their impact on efforts to obtain federal relief from some of the competitive disadvantages under which state-chartered institutions are forced to operate. For there can be little doubt that the statutory and administrative weaknesses found in a majority of the states have dominated the attitudes of the federal bank agencies and the Congress whenever suggestions are made for greater state responsibility in the supervision of state-chartered banks and associations—even though there is little justification for these attitudes in the case of the dozen or so states that are doing an effective job of bank

⁴² The New York Banking Law permits state-chartered banks, if they are not members of the Federal Reserve System, to treat their demand deposit balances with correspondent banks as part of their required reserves. See N.Y. BANKING LAW §§ 33, 107. Some small nonmember banks have even been borrowing their required reserve balances from their correspondents at low interest rates, thus freeing their own funds for lending or investment purposes. National banks, as members of the Federal Reserve System, have to maintain their required reserves in Federal Reserve Banks, and cannot use their balances with correspondent banks for this purpose.

⁴³ Eight of the eleven recommendations, including all of the Committee's major recommendations, were subsequently enacted by the New York Legislature; these eight were: (a) authority for New York-chartered banks, within certain limitations, to purchase equipment and other personal property for the purpose of leasing such property to business customers ("direct lease financing"); (b) authority for New York-chartered banks to purchase open accounts receivable "without recourse," an authority necessary for conducting a general factoring business; (c) authority for New York-chartered banks to furnish travel agency services to the general public, and not merely to existing customers; (d) an exemption from statutory lending limits for federal-funds transactions by New York-chartered banks; (e) authority for separate statutory lending limits when New York-chartered banks make business loans to corporate customers and also buy marketable debt securities of proven quality issued by the same customer; (f) authority for the New York State Banking Board to delegate to the Superintendent of Banks alone the power to decide branch applications of New York-chartered banks pursuant to standards set by the Board; (g) simplified procedural requirements for the approval of certain overseas branches of New York-chartered banks; and (h) simplified procedural requirements for the approval of new offices acquired by a New York-chartered bank in a merger or other acquisition approved by the Superintendent of Banks. N.Y. Sess. Laws 1966, ch. 324. For a fuller discussion of these recommendations, see ADVISORY COMMITTEE ON COMMERCIAL BANK SUPERVISION, REPORT SUBMITTED TO THE SUPERINTENDENT OF BANKS OF THE STATE OF NEW YORK (December 1965).

supervision. Despite verbal commitment to a dual system of regulation, the actions of Congress and the federal bank agencies reflect considerable reluctance to grant the states any additional responsibilities and an equal readiness to impose ever more federal control and direction over state-chartered institutions.⁴⁴

If federal action is necessary before state banking regulation can become truly effective, as I believe it is, this attitude must be reversed. But this attitude is not likely to be reversed nor is federal action likely to be forthcoming until significant improvements are made in the vast majority of state banking codes and state banking departments. These improvements, quite properly, must be the first order of business for states that seek an improved regulatory climate for state-chartered financial institutions. Fortunately, there is growing recognition of the need in both areas, and recent efforts of the American Bankers Association, the National Association of Supervisors of State Banks, and groups of bankers and bank lawyers in individual states have produced marked improvements in several states. Nationwide, the impact of their efforts is increasing, hopefully with sufficient speed so that Congress and the federal bank agencies will find it possible in the near future to remedy some of the federal problems inherent in a system of dual regulation.

CONCLUSION

Almost half of the total assets held by all commercial banks, savings banks, and savings and loan associations in the country are held by institutions subject to state supervision and regulation. Yet state banking systems operate under serious handicaps, which only a joint effort at state and federal levels can overcome.

Efforts to update state banking laws and to strengthen state banking departments must continue, for they are the key to effective state supervision. But these efforts alone will not insure basic equality or vigor to state banking systems, so long as there are significant unresolved problems caused by the added supervision of state-chartered financial institutions at the federal level and by the general presumption that national banks and federal savings and loan associations are entitled, in conducting interstate business, to special privileges, protections, and immunities as "federal instrumentalities."

Disparities of power and opportunity between state-chartered and federally chartered institutions which exist for these reasons are beyond the power of individual states to remedy, and yet they may be even more meaningful for particular institutions than the disparities which exist by virtue of state law or state administration.⁴⁵

⁴⁴ See, e.g., Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028 (codified in scattered sections of 12 U.S.C.), which gives the federal banking agencies significant new powers of supervision over state-chartered as well as federally chartered financial institutions.

⁴⁵ Of the possible disparities between state-chartered and federally chartered financial institutions, the most significant competitively for almost all banks would be an inability to obtain approval of branch applications and merger-type applications with the same ease under similar factual circumstances. It should be noted, however, that this disparity may arise either at the state or federal level. If, for example, a state banking department or a reviewing federal agency were to take a relatively restrictive

A concerted and determined effort, by state supervisors, federal banking officials, and the Congress, must be undertaken promptly to resolve the more significant problems in this category which center on dual examinations, operations subsidiaries, the underwriting of revenue bonds, dual applications and approvals for branches and mergers, and the increasingly significant area of interstate banking transactions.

Without timely reforms at the federal level, and at the state level in states which now have antiquated laws and weak supervision, I consider the future prospects of state banking regulation to be bleak. With such action, it may again be possible to realize the many advantages of decentralized regulation for state-chartered banks and the public they serve.

view on new branch locations or proposed acquisitions while the Comptroller of the Currency was pursuing a more liberal policy for national banks, under substantially identical statutory standards, the large state bank which seeks aggressively to expand is likely to be unimpressed by the lesser advantages of state charter. If the disparity occurs at the federal level because of the restrictive attitude of the Board of Governors of the Federal Reserve System or the Federal Deposit Insurance Corporation, conversion to national bank status would be likely even though the state banking department with jurisdiction were to take a relatively liberal view, similar to the Comptroller's, on such matters.

Large state-chartered savings and loan associations in New York have had a somewhat different problem. They are, by statute, limited to a specific number of branch offices ranging from one to seven depending on the location of the association's head office. N.Y. BANKING LAW § 396(2). Federal savings and loan associations, by contrast, are not subject to any such a numerical limitation. Not surprisingly, there has been a steady decline in the number of state-chartered savings and loan associations in the State of New York with savings deposits of over \$50 million. Today only 12 of the 40 associations in this category remain under state supervision.